Pensions, retirement and markets: 5 questions for 2018

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Here are five issues which are likely to impact the retirement and pension industry in 2018. (Photo: Shutterstock)

As we look ahead, here are five issues which are likely to impact the retirement and pension industry in 2018:

#1: Will tax reform impact savings and retirement?

It is still far from certain that comprehensive tax reform will be passed by Congress, given the complexities of the tax code, political/social considerations and budget deficit concerns.

That said, there have been calls to pay for tax cuts by lowering the deductible limits of before-tax employee contributions to 401(k) plans.

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Some have called this the "Rothification" of 401(k)s and it has generated strong opposition from the retirement industry. While 401(k) contribution limits have not been part of the initial tax reform proposals, there is likely a long road ahead, so stay tuned.

#2: What will happen with interest rates?

Predicting what the Federal Reserve will do can be tricky, particularly with a new Chairman to be seated in 2018.

The market currently expects a rate increase in December, with several additional hikes expected in 2018. These rate hikes should give at least a small boost to CD and money market rates for savers and retirees.

However, the effect on pension funding ratios is more complicated. Longer term interest rates are driven by a number of factors such as inflation, supply/demand, the economy and deficits.

If longer-term interest rates fall, then pension liabilities will increase and required contributions may be necessary if the equity markets do not continue their run.

#3: How will Pension Benefit Guaranty Corporation (PBGC) premiums be managed?

Flat rate PBGC premiums will rise from $69 to $74 per participant in 2018 while variable rate premiums for underfunded plans will increase from $34 to $38 per $1,000 of underfunding.

Pension sponsors have looked to mitigate the impact of premium increases by implementing structural changes to their plans to reduce headcount and funding deficits, including the following: lump sums, early retirement incentives, advance funding, partial or full freezing of plans and annuitization of benefits through third parties.

We expect these trends to continue in 2018.

#4: Will the Department of Labor (DOL) fiduciary rule continue as a significant force?

The DOL fiduciary rule went partially into effect in June 2017 while fully required implementation has been delayed until July 2019.

Despite opposition from industry groups and members of Congress, many advisors and portfolio managers have restructured their product offerings in order to comply with the fiduciary rule.

Changes have included lower expense ratios, elimination of commissions in favor of flat asset-based fees and elimination of mutual fund share classes with high loads. Despite uncertainty as to the final shape the fiduciary rule will take, the bottom line is that financial advisors will be held to a higher fiduciary standard.

#5: Will exchange-traded funds (ETFs) continue their boom as an investment option?

While ETF assets remain a relatively small fraction of total passive index funds plus actively managed funds, there has been an explosion in ETFs.

The 1,716 ETFs at year-end 2016 are more than double the number at the end of 2009 and total $2.5 trillion in assets (per 2017 Investment Company Factbook).

While $1.1 trillion has flowed out of actively managed domestic equity mutual funds from 2007-2016, there has been an inflow of about $800 billion into domestic equity ETFs over the same period (per 2017 Investment Company Factbook).

ETFs generally mirror the performance of a sector of the market and trade like a stock with real time pricing. ETF fees are generally higher than a large cap index fund but lower than an actively managed mutual fund.

The flexibility, lower fees and liquidity of ETFs suggest that more and more ETFs will hit the market and assets will continue to grow as advisors look to this product for investors.

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